Irish Economy

Q1 2023 Health Check

Data Insights by Goodbody Analytics

War chests

Economic Research **23 Jan 2023**

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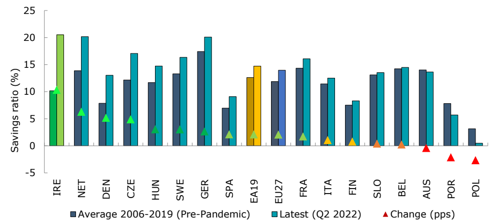
Global headwinds, but "war chests" can be utilised

Being one of the most open economies in the world, Ireland is vulnerable to slowing global growth and to high inflation. Modified domestic demand is now expected to slow to 0.7% in 2023, down from 5.6% in 2022. While the euro area and UK are expected to be in recession this year, we believe that Ireland can avoid this due to a record household savings haul and the ability for government supports due to the best budget position in the euro area – Ireland's "war chests".

Irish households experienced biggest increase in savings

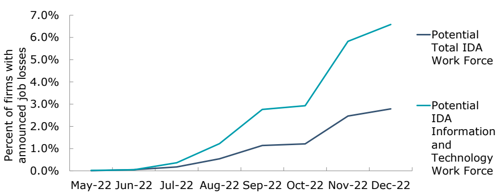


Source: Goodbody, Eurostat

Tech job losses growing, but a small part of IDA companies impacted

In this report, we lay out ten major issues of relevance for investors interested in Ireland in 2023. Given its role in the growth of FDI in recent years, the recent job loss announcements in the tech sector are of concern. Our analysis shows that outside of a few high-profile exceptions, the crossover to tech companies based in Ireland is quite small, with an estimated 3% of FDI companies impacted to date.

Tech job losses are growing, but remain low

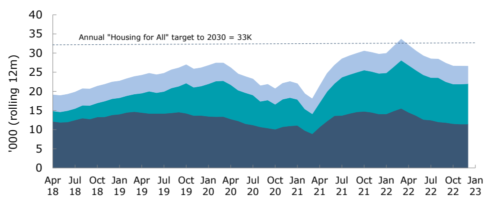


Source: Goodbody Analytics, IDA, LayoffTracker

Increased government support in housing supply

Housing is now the number one political priority for the Irish government. A rise in residential yields and increase in construction costs is threatening the viability of apartment-building. Residential commencements are now well below annual requirements. Increased government support will be required to ensure that housing supply does not fall any further below targets. This government support should be used to secure funding for additional private units.

Housing starts now slowing to mid-20k level



Source: Goodbody Analytics

Economic Indicators

	2021	2022f	2023f	2024f
Growth Components				
Consumption	4.6%	5.7%	2.5%	3.2%
Government	6.5%	-0.1%	1.4%	2.0%
Investment	-39.0%	36.7%	-0.3%	1.4%
- Modified Investment	-39.0%	36.7%	-0.3%	1.4%
Domestic Demand (DD)	-18.2%	16.9%	1.0%	2.2%
- Modified DD	2.5%	5.6%	0.7%	2.3%
Exports	14.1%	13.0%	4.7%	4.5%
Imports	-8.3%	18.3%	4.8%	4.7%
GDP	13.6%	11.2%	2.3%	2.8%
GNP	14.7%	8.3%	1.5%	2.4%
Prices				
Consumer Price Inflation	2.4%	7.8%	5.6%	2.8%
House Price Inflation (end-year)	14.2%	8.0%	3.2%	4.1%
Wage Inflation (GBS)	4.8%	3.5%	4.5%	3.5%
Fiscal				
GGB / GDP	-2.0%	0.9%	1.1%	1.0%
Debt/GDP	55%	46%	43%	41%
Consumer Profile				
Employment Growth (end year)	10.1%	2.7%	0.2%	1.1%
Unemployment Rate (end-year)	5.2%	4.5%	5.5%	5.8%
Exchange Rates (Avg for the year)				
€/$	1.18	1.06	1.09	1.18
€/£	0.86	0.85	0.89	0.90

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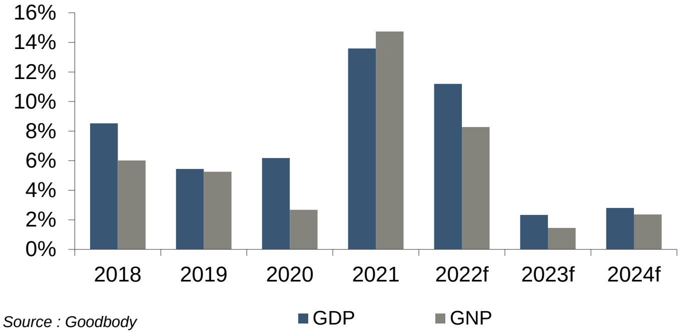
DOMESTIC MACRO DATA	2020a	2021a	2022f	2023f	2024f
Growth Components					
Consumption	-10.9%	4.6%	5.7%	2.5%	3.2%
Government	11.6%	6.5%	-0.1%	1.4%	2.0%
Investment	-16.5%	-39.0%	36.7%	-0.3%	1.4%
- Modified Investment	-16.5%	-39.0%	36.7%	-0.3%	1.4%
Domestic Demand (DD)	-11.6%	-18.2%	16.9%	1.0%	2.2%
- Modified DD	1.8%	2.5%	5.6%	0.7%	2.3%
Exports	11.2%	14.1%	13.0%	4.7%	4.5%
Imports	-2.1%	-8.3%	18.3%	4.8%	4.7%
GDP	6.2%	13.6%	11.2%	2.3%	2.8%
GNP	2.7%	14.7%	8.3%	1.5%	2.4%
Housing Statistics					
Completions	20,585	20,560	28,373	27,322	26,047
Average House Price (€k)	280,267	320,101	345,582	356,537	371,155
House Price Inflation (end-year)	2.2%	14.2%	8.0%	3.2%	4.1%
Mortgage Credit Growth (end-year)	0.9%	1.2%	-0.6%	1.8%	2.2%
Prices					
Consumer Price Inflation	-0.3%	2.4%	7.8%	5.6%	2.8%
Wage Inflation (GBS)	5.0%	4.8%	3.5%	4.5%	3.5%
Fiscal					
Exchequer Balance	-12,315	-7,372	4,884	7,002	6,598
Exchequer Balance / GNP	-4.4%	-2.3%	1.3%	1.8%	1.6%
General Government Balance	-18,415	-8,522	4,430	5,758	5,364
GGB/GDP	-4.9%	-2.0%	0.9%	1.1%	1.0%
GGB/GDP - ex banking costs	-4.9%	-2.0%	0.9%	1.1%	1.0%
Debt/GDP	58%	55%	46%	43%	41%
Consumer Profile					
Employment Growth (end year)	-3.4%	10.1%	2.7%	0.2%	1.1%
Employment Growth (Full-year avera	-2.8%	6.0%	6.6%	0.9%	0.8%
Unemployment Rate (end-year)	6.3%	5.2%	4.5%	5.5%	5.8%
Debt/Disp. Income	106%	98%	92%	90%	89%
Interest Rates (At year end)					
ECB	-	-	2.50%	3.50%	2.75%
BoE	0.10%	0.25%	3.50%	4.25%	3.00%
Fed	0.25%	0.25%	4.50%	5.25%	3.50%
Trade					
Current Account (€m)	-78,976	-45,170	-4,026	-179,855	-101,010
CA as a % of GDP	-21.2%	-10.6%	-0.8%	-34.4%	-18.5%
Exchange Rates (Average for the year)					
€/$	1.14	1.18	1.06	1.09	1.18
€/£	0.89	0.86	0.85	0.89	0.90

SOVEREIGN ANALYSIS	2020a	2021a	2022f	2023f	2024f
Debt/GDP					
Austria	83%	82%	79%	77%	75%
Belgium	112%	109%	106%	108%	109%
Cyprus	114%	101%	90%	84%	78%
Finland	75%	72%	71%	72%	73%
France	115%	113%	112%	111%	110%
Germany	68%	69%	67%	66%	65%
Greece	206%	195%	171%	162%	157%
Ireland	58%	55%	46%	43%	41%
Italy	155%	150%	145%	144%	143%
Luxembourg	25%	25%	24%	26%	26%
Malta	53%	56%	57%	60%	61%
Netherlands	55%	52%	50%	52%	53%
Portugal	135%	126%	116%	109%	105%
Slovakia	59%	62%	60%	57%	57%
Slovenia	80%	75%	70%	70%	69%
Spain	120%	118%	114%	113%	112%
Eurozone avg.	99%	97%	94%	92%	91%
GGB/GDP					
Austria	-8.0%	-5.9%	-3.4%	-2.8%	-1.9%
Belgium	-9.0%	-5.6%	-5.2%	-5.8%	-5.1%
Cyprus	-5.8%	-1.7%	1.1%	1.1%	1.6%
Finland	-5.5%	-2.7%	-1.4%	-2.3%	-2.3%
France	-9.0%	-6.5%	-5.0%	-5.3%	-5.1%
Germany	-4.3%	-3.7%	-2.3%	-3.1%	-2.6%
Greece	-9.9%	-7.5%	-4.1%	-1.8%	-0.8%
Ireland	-4.9%	-2.0%	0.9%	1.1%	1.0%
Italy	-9.5%	-7.2%	-5.1%	-3.6%	-4.2%
Luxembourg	-3.4%	0.8%	-0.1%	-1.7%	-0.5%
Malta	-9.4%	-7.8%	-6.0%	-5.7%	-4.4%
Netherlands	-3.7%	-2.6%	-1.1%	-4.0%	-3.1%
Portugal	-5.8%	-2.9%	-1.9%	-1.1%	-0.8%
Slovakia	-5.4%	-5.5%	-4.2%	-5.8%	-4.7%
Slovenia	-7.7%	-4.7%	-3.6%	-5.2%	-2.7%
Spain	-10.1%	-6.9%	-4.6%	-4.3%	-3.6%
Eurozone avg.	-7.0%	-5.1%	-3.5%	-3.7%	-3.3%
10Y Spread to Germany	**2019a**	**2020a**	**2021a**	**2022a**	**Current**
Austria	0.19	0.14	0.25	0.63	0.52
Finland	0.21	0.15	0.26	0.56	0.49
France	0.31	0.23	0.38	0.54	0.43
Netherlands	0.13	0.08	0.15	0.32	0.26
Belgium	0.27	0.19	0.36	0.64	0.51
Spain	0.65	0.61	0.75	1.08	0.94
Italy	1.61	1.12	1.35	2.10	1.72
Portugal	0.61	0.60	0.64	1.04	0.82
Greece	1.64	1.19	1.50	2.05	1.97
Ireland	0.30	0.26	0.43	0.53	0.37

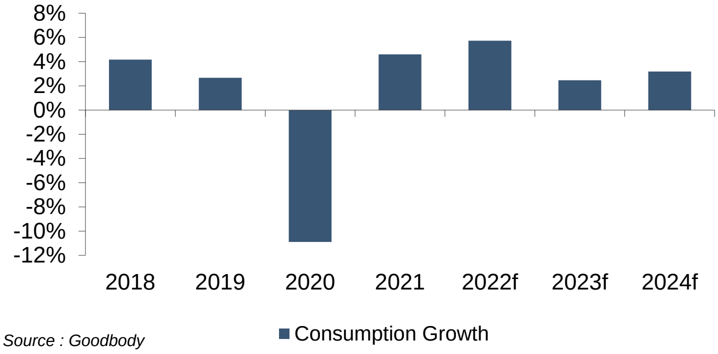
Source: FactSet & European Commission

Irish economic growth



Source : Goodbody

Consumption Growth



Source : Goodbody

War chests – Key themes

Sharp slowdown, but "war chests" mean no recession

- Sharply lower global growth, and the likelihood of recession in some of Ireland's major trading partners, provides a difficult backdrop for small, open economies. High inflation, rising interest rates and the uncertainty caused by the war in Europe are all contributory factors. The recent collapse in energy prices provides some scope for optimism but is unlikely to alter the path towards tighter financial conditions.
- Fortunately, there are a few unique current features of the Irish economy that can help to offset these headwinds. Firstly, the government has the resources to continue to use aggressive targeted fiscal supports for households and businesses most influenced by these temporary external pressures as a result of its ongoing budget surpluses. Secondly, households in aggregate are in good shape due to the highest savings position in the euro area. These "war chests" can be utilised to ensure another year of growth in the economy. We are forecasting that modified domestic demand grows by 0.7% in 2023 and 2.3% in 2024.

We highlight ten key issues for the Irish economy in the year ahead

- At the start of every year, we lay out what we believe are the ten big issues for the Irish economy. The list is not exhaustive but provides a guide for those interested in the prospects of the Irish economy. The ten big issues are: (1) Eye of the storm – Ireland amidst a global recession; (2) Inflation pressures to abate from highs; (3) Household savings position provides a war chest; (4) How will Ireland cope with higher interest rates?; (5) Softer growth to take steam out of tight labour market; (6) Government to become increasingly important player in housing supply; (7) Public finances the best in Europe- what is the outlook?; (8) Tech sector unwind is a risk, but job losses are manageable thus far; (9) How will businesses fare in a tougher environment?; (10) Supply-side investments must remain a priority.

Irish household savings ratio is the highest in the euro area

- Households enter the current crisis with plenty of resource in their war chests to combat the real earnings hit in 2023. Irish households had the highest savings ratio in the European Union in 2022. As a result of savings built up over the pandemic period, we estimate that Irish households have built up an "excess" savings pool equal to 19% of disposable incomes. Household debt is also at all-time lows. We expect consumers to lower their savings rate to combat higher living costs, but to continue to save at a higher rate than before the pandemic. We still expect consumption growth, albeit at a much lower rate than 2022, but there are upside risks here as households may decide to dip into excess savings.

Inflation to abate from highs

- Inflation continues to challenge households and businesses in 2023. While headline inflation has passed its peak, currently sitting at 8.2%, underlying inflation pressures remain a concern. Core inflation has been sitting stubbornly at 5.5% for some months now, driven by services inflation, which at present is contributing half of the rise in consumer prices. This will be a tougher element of inflation to pull down, as the sectors labour-intensity links inflation closely to wage growth. Wage growth has risen, but not yet to worrying levels. It must however be noted that there are upside risks due to the tightness of labour market conditions.

Labour market to cool from record tight position

- The labour market is tight. Unemployment continues to fall, currently at 4.3%, while employment continues to reach new highs with no signs of vacancies falling away substantially. For context, job postings on Indeed are 60% above pre-pandemic levels. This is strong in an international context. While this is supportive of additional wage growth, we expect a softening of employment growth and rise in unemployment. This will act to keep a lid on wage growth.

Tech sector downturn is a risk, but job losses to date are estimated to be small

- The multinational sector has provided huge benefits to Ireland over recent years, contributing to employment, earnings, taxes and economic growth generally. Employment in IDA-related companies reached a new high in 2022. There are concerns however surrounding FDI into Ireland. The first of those is through exposure to investment from the UK and the US (c.80%), two economies at high risk of recession in 2023. The second, is the recent wave of tech layoffs given Ireland's exposure to that sector. Our analysis shows that the potential job losses in Ireland from this wave of announcements is small in the context of the wider labour market to date, amounting to less than 3% of IDA-supported employment. We do not rule out further job losses in this sector however. While there are clear cyclical risks to FDI, we believe that Ireland's position in the tech and pharmaceutical sectors will prove beneficial over the medium-term. Falling tax revenues as a result of lower profitability is a greater risk.

More government support required to stall downward trend in housing supply

Having grown strongly since the ending of pandemic restrictions, there are signs that new housing supply in Ireland is now rolling over. This is happening at a time when housing demand is in fact growing at a faster pace, with a realisation that the government targets for housing supply will soon have to be revised upwards. A rise in interest rates and higher construction costs has threatened viability within the apartment market in particular due to the retreat of Private Rental Sector (PRS) investors. In the short-term at least, there is a need for the Irish government to attempt to fill this gap to ensure that housing supply does not fall any further.

Government in a position to provide further temporary fiscal supports

- A boom in tax revenues in Ireland catapulted Ireland's public finances to the best position in Europe in 2022. Ireland finished the year with a budget surplus of 2% of GNI*, the biggest budget surplus since 2006. Coming after Brexit supports and COVID-related spending, the cost-of-living crisis has brought a need for further "temporary" fiscal measures for the Irish government. To date, the Irish government has provided €7.7bn in fiscal supports to help counter the effects of the rise in costs for businesses and households. It has also articulated its willingness to roll over these fiscal supports should they be required later this year. Debt metrics are now on a firm downward trajectory, with the debt/GNI* ratio expected to fall to 88% in 2023 and to 83% by the end of 2024. While this remains high in an historical context, it is below the euro area average of 92%. Along with the expected surpluses, Ireland also has relatively small redemption requirements over the 2023/2024 period, with only €7bn and €8bn redeeming over the next two years, respectively.

Irish Economy Health Check – War chests

Forecast update

Ireland continued to grow rapidly in 2022, supported by ongoing expansion of the multinational sector, rebounding consumer spending after lockdowns in the previous two years and robust household and business sector balance sheets. In GDP terms, we estimate the economy grew by 11% last year, the fastest in the euro area by far. Net exports continued to play an oversized role in this growth, with both goods and services exports reaching another record high despite concerns about a global slowdown.

There are well known statistical issues with the calculation of GDP in Ireland due to the large multinational sector in Ireland, but we should not dismiss it for its information content entirely. These exporting firms have played a vital role in the growth in employment, incomes and tax revenues over recent years, helping Ireland to be the fastest-growth economy in the euro area over the period since 2020. However, GDP has the drawback of significant volatility and is sometimes not reflective of underlying economic activity. Modified Domestic Demand (MDD) provides a better gauge of underlying growth developments, and they are equally as impressive.

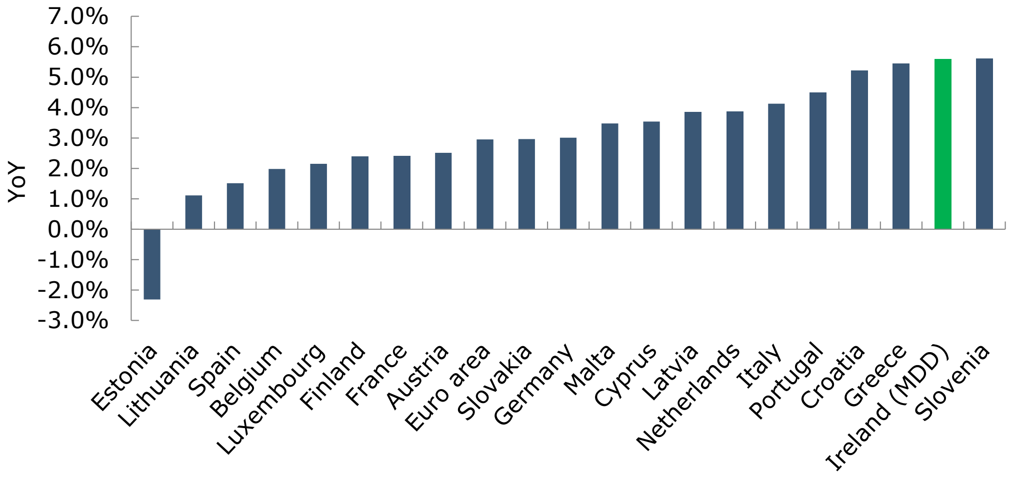
Irish growth forecasts

	2020	2021	2022e	2023f	2024f
Consumption	-10.9%	4.6%	5.7%	2.5%	3.2%
Investment	-16.5%	-39.0%	36.7%	-0.3%	1.4%
Core investment	36.1%	-9.0%	7.6%	-5.1%	0.1%
Government	11.6%	6.5%	-0.1%	1.4%	2.0%
Domestic Demand	-11.6%	-18.2%	16.9%	1.0%	2.2%
- Modified domestic demand	**1.8%**	**2.5%**	**5.6%**	**0.7%**	**2.3%**
Exports	11.2%	14.1%	13.0%	4.7%	4.5%
Imports	-2.1%	-8.3%	18.3%	4.8%	4.7%
GDP	**6.2%**	**13.6%**	**11.2%**	**2.3%**	**2.8%**
GNP	2.7%	14.7%	8.3%	1.5%	2.4%

Source: Goodbody, CSO

We estimate that MDD grew by 5.6% in 2022. As shown on the chart on the next page, this is once again among the fastest growing in the euro area, continuing a trend that has been in place for most of the past decade. A rebound in consumer spending post the ending of the pandemic-induced lockdowns made a big contribution, despite the squeeze to disposable incomes that occurred in the second half of the year. Investment also rebounded strongly last year due to two factors. Firstly, residential construction rapidly, reflecting the pent-up supply of new properties from the delays of the 2020/2021 period. Secondly, there was another strong year of investment in core business investment. In the context of ongoing low levels of domestic SME lending activity this is somewhat surprising and is thus likely due to the contribution of several large projects being undertaken by the multinational sector in Ireland, including in data centres. This latter factor has put pressure on Ireland's energy situation that has become more acute given the wider energy market problems in Europe in the aftermath of the Ukraine war.

Domestic demand growth compared – Ireland one of the fastest growing once again in 2022



Source: Goodbody

We are anticipating a relatively sharp slowdown this year on the back of an outright fall in core investment and significantly slower growth in consumer spending. We are taking a more cautious view than most on investment activity due to an expectation of a fall in the volume of construction output and an easing of business investment following the rapid growth of the past two years amid a global economic slowdown. We believe that the development of data centres has played a large role in this growth but has put pressure on Ireland's energy supply. This has triggered the decision to selectively ration the approval of new data centres.

As we detail later in the report, Irish households are in relatively good shape to cope with the short-term squeeze on their incomes due to the inflation surge. This is due to a combination of a strong household balance sheet position, a high starting position for the savings ratio (c.20%) and the existence of significant government supports and the prospect of more to come due to the strong fiscal position.

Concerns have emerged recently around the health of the technology sector globally. The growth in this sector in Ireland has been pivotal to the FDI-driven growth story over recent years. Our analysis shows that the crossover of those companies that have announced job cuts globally and those with operations in Ireland is quite limited to date. While we do not discount further announcements on consolidation over the course of 2023, we are confident that the sector will continue to grow over the coming years, with Ireland being an important part of those growth plans for some of the largest and most profitable companies in the sector. The bigger risk from this development stems from the expected fall in tax revenues as profitability wanes. We discuss this in our public finances sector.

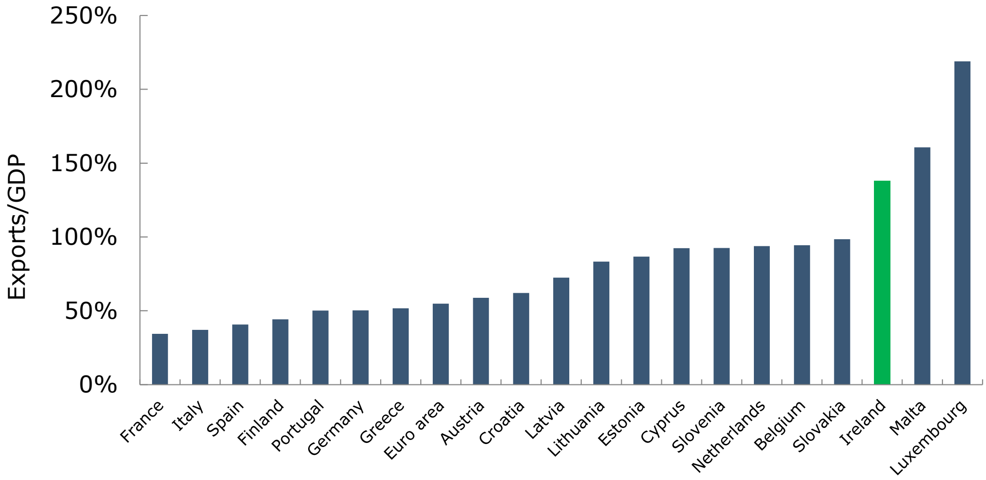
10 key issues for the Irish economy in 2023

As is now customary, we concentrate our first *Irish Economy Health Check* of the year on the ten issues that we believe investors interested in Ireland should be aware of. For 2023, they are:

1. Eye of the storm - Ireland amid a global recession

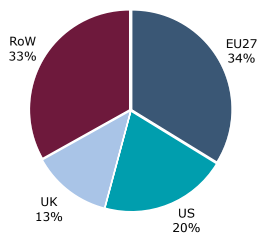
Both the UK and the euro area are likely to be in recession at the start of 2022, with the US expected to enter contraction by the middle of the year. These three regions account for more than two thirds of Ireland's exports, highlighting the difficult external environment for Ireland, one of the most open economies in the developed world.

Ireland's high export dependency highlights its exposure to international events



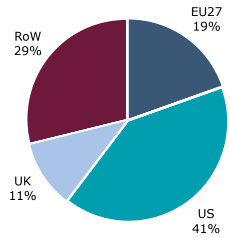
Source: AMECO

Geographical share of Irish exports



Source: CSO

Geographical source of imports to Ireland



Source: CSO

This comes after an extraordinary period of growth in exports of goods and services from Ireland over recent years. Ireland was a key beneficiary of some key pandemic-related trends in the pharmaceutical, medical devices and Information & Communication Technology sectors. As the table on the next page shows, computer services are Ireland's largest export category by value, accounting for 31% of the total in 2021. The second biggest category is "Chemicals and related products". As evidenced by a series of announcements on rationalisation over recent months, the ICT sector is clearly reassessing its growth prospects after the pandemic boom. Ireland, being a hub to most of the very largest companies in the sector will be impacted by this in the short-term. In the medium-term, however, we still believe that the sector is in structural growth. In the context of rising wealth and an aging global population, there are also structural growth drivers in place for the pharma and medical devices sector. The exposure to less cyclical sectors suggests that Ireland will not be as susceptible to the economic cycle as some other economies.

Breakdown of Irish exports by type

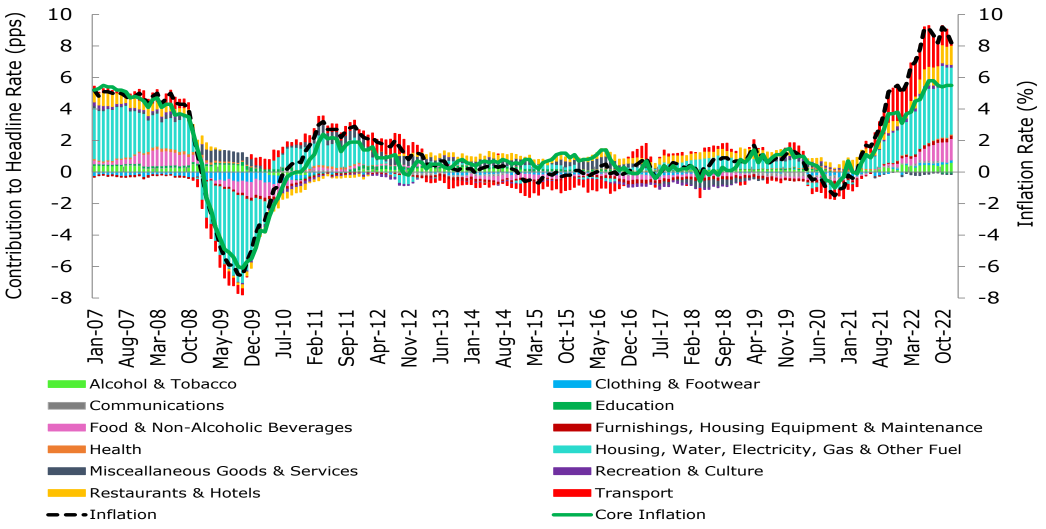
	Value	% of Total Exports
Goods		
Chemicals and related products	102,603	18%
Machinery and transport equipment	25,025	4%
Miscellaneous manufactured articles	17,404	3%
Food and live animals	12,129	2%
"Goods for processing"*	100,928	18%
Other goods	8,553	2%
Total goods	**266,643**	**48%**
Services		
Computer services	172,857	31%
Other business services	49,858	9%
Financial	22,152	4%
Insurance	13,681	2%
Other services	35,081	6%
Total services	**293,629**	**52%**
Total exports	**560,272**	**100%**

Source: CSO, 2021 data *refers to exports that don't officially cross Irish border but are controlled by an Irish-registered company

2. Inflation pressures to abate from highs

Inflation has been a significant headwind for the global economy over the past twelve months. We expect this to continue in H1 2023, but abate as the year progresses, especially if the recent fall in wholesale energy prices is sustained. We expect headline inflation to fall over the next two years but there are notable underlying inflation risks. Inflation was at 8.2% yoy in December and has moved well, below the October peak of 9.2% yoy when energy companies pushed through price increases to household bills. Prices fell 0.2% mom in December, the first monthly decline in the month of December since 2018.

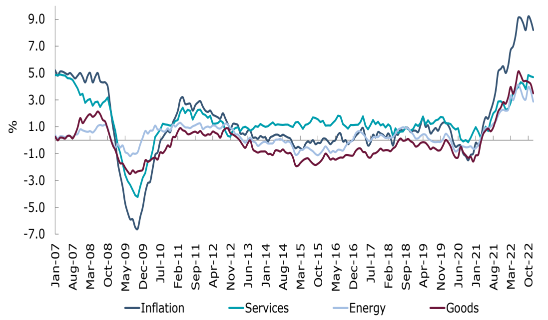
Irish CPI Inflation, Core Inflation (CPI ex. Energy and Food) and COICOP Contributions (%)



Source: Goodbody, CSO

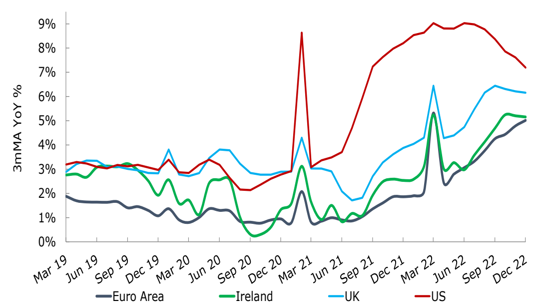
Controlling core inflation is a trickier task. In Ireland, core inflation currently sits at 5.5% and has been around that level consistently since September 2022. The concern here is that services inflation, which tends to be stickier due to the sector's labour intensity, continues to put upward pressure on underlying prices that is not related to energy. The services sector is at present contributing 4.7ppts to headline inflation, which is more than half of total. This contribution has been trending upwards. The biggest risk to this underlying inflation pressure is wage growth. Ireland has experienced a more moderate increase in wages relative to international peers, but it remains high in an historical context. The *Indeed Hiring Lab* wage tracker shows posted wages grew 5% yoy in December, but we believe the risks to this number lie to the upside in the short-term.

Inflation High-Level Sector Contributions



Source: Goodbody, CSO

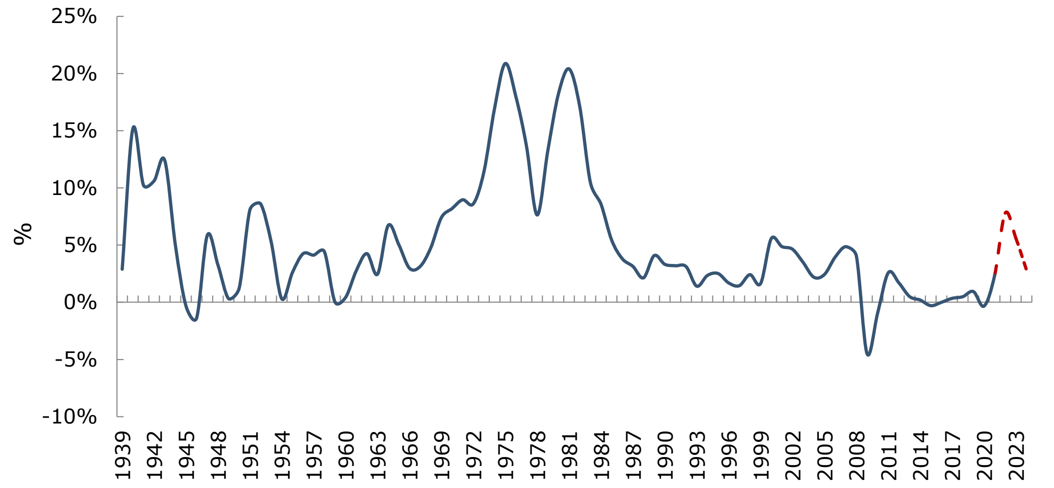
Growth in Posted Wages on Indeed.com



Source: Goodbody, Indeed Hiring Lab

We expect inflation to fall to 5.6% by the end of 2023 as energy and food prices begin to come out of the inflation rate relatively quickly. Importantly, we do not assume energy price reductions by the utility companies, but this is a source of potential positive surprise given the collapse in wholesale gas prices. The 5.6% figure is however reflective of the more difficult challenge that will be undoing the core inflation pressures that are currently present. Inflation is forecast to fall further throughout 2024, reaching 2.8% by year-end.

Inflation in Ireland 1939-2024*



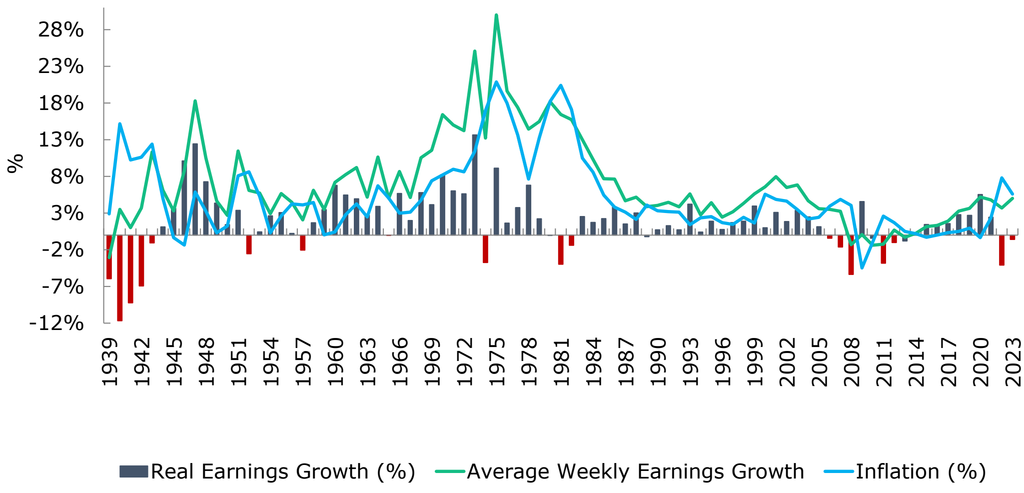
Source: Goodbody, CSO

***Goodbody Economics Inflation Forecasts are applied from 2022-2024 and are depicted by the red dashed line.**

3. Households savings position provides a "war chest"

High inflation continues to depress real incomes across the developed world, providing downside risks to consumption. In Ireland, we expect the brunt of the real earnings hit to have occurred in 2022, where we estimate that real earnings fell 4%. A much smaller reduction is forecast for this year before Irish consumers return to experiencing real wage gains in 2024.

Real Earnings Growth 1939-2023*

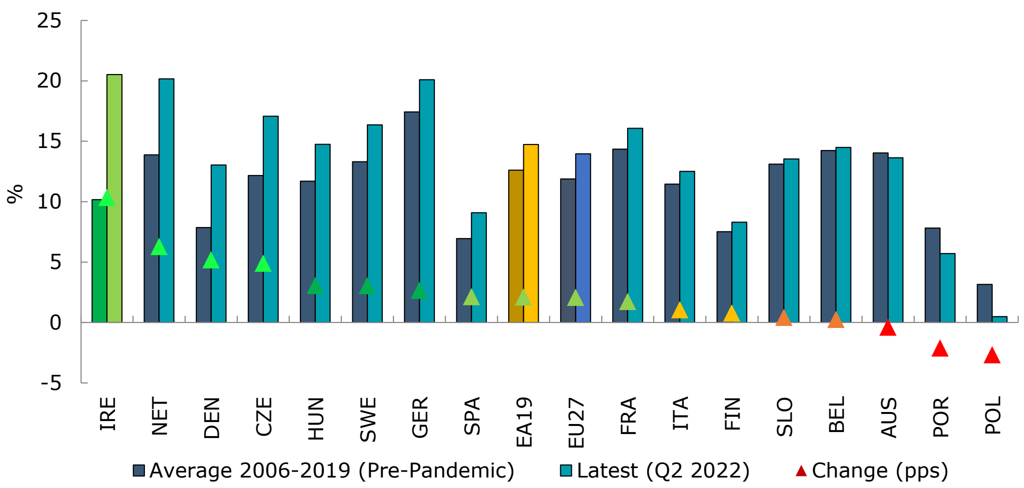


Source: Goodbody, CSO

***2022 and 2023 are based on Goodbody Economics forecasts**

Fortunately, Irish household are relatively well positioned for this short-term hit. As of Q2 2022, the Irish household savings rate was still above 20%. This was the highest in Europe and means Ireland experienced the largest shift in savings behaviour during the pandemic, and a behaviour that is persisting. This provides an important buffer as real incomes fall.

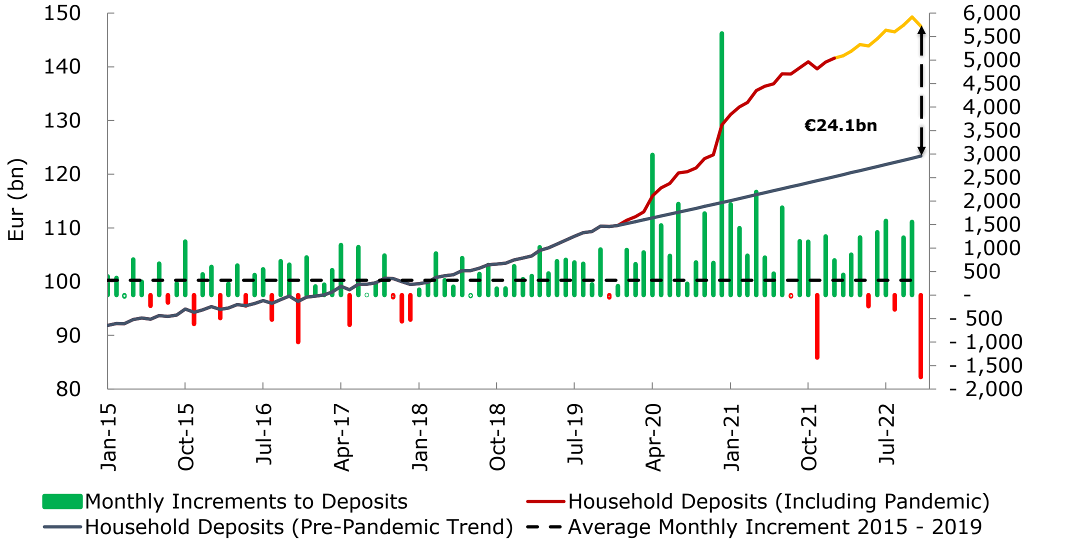
European Savings Ratios vs Pre-Pandemic Average



Source: Goodbody, Eurostat

This structural change in savings behaviour has led to an excess deposit pool among Irish households of €24bn as of November 2022. This is equivalent to 19% of gross household disposable income. There have been no signs as yet of this trend reversing and we assume households will not dip into this pool of excess savings when producing our consumption forecasts.

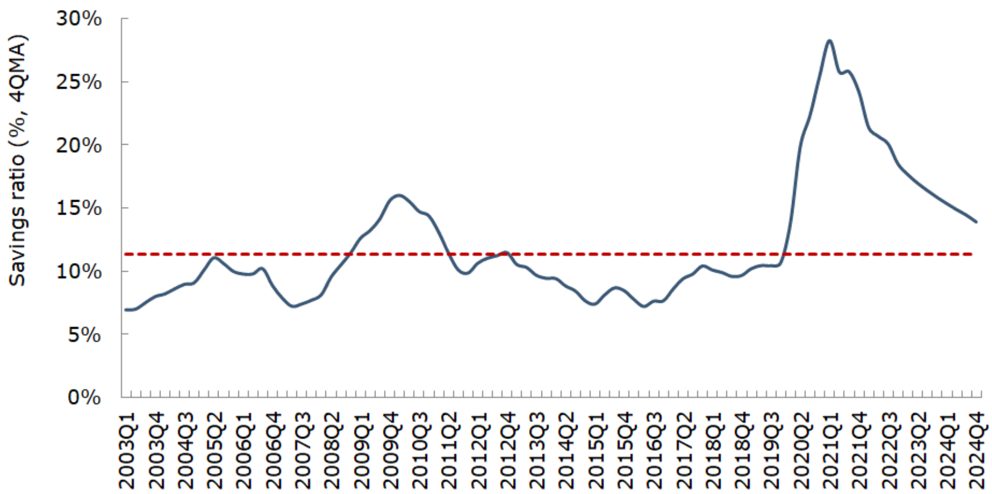
"Excess" household deposits now amount to €24bn



Source: Goodbody, Central Bank of Ireland

Indeed, we expect the household savings ratio to remain above its pre-pandemic levels throughout our forecast horizon to 2024. As shown below, this is well above the long-term average.

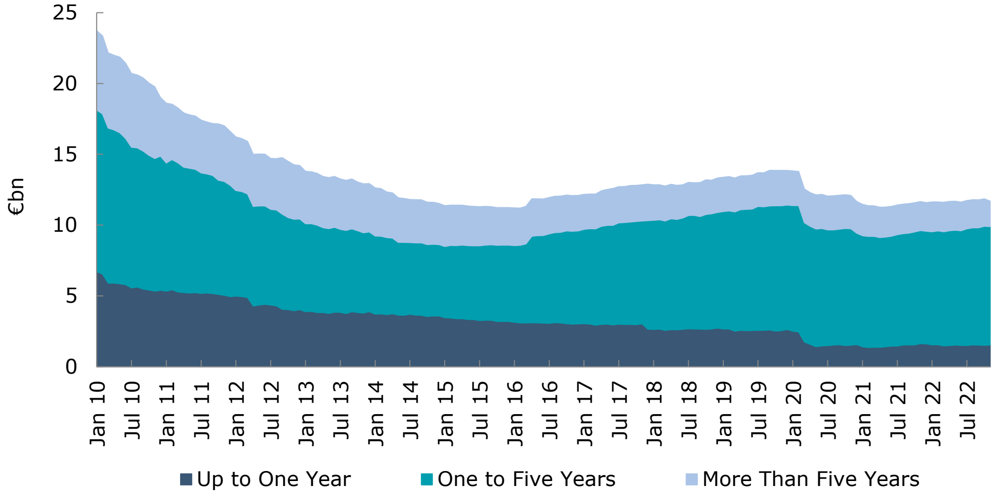
Household savings ratio remains well above pre-pandemic levels



Source: Goodbody

Another aspect of household positioning that provides comfort in an Irish economic context is the relatively low rate of household consumer credit lending, with little sign of consumers having to resort to short-term sources of finances. Following decade of de-leveraging after the Global Financial Crisis, consumer credit lending growth is currently at just 1% yoy.

Consumer Credit by Maturity Profile 2010-2022

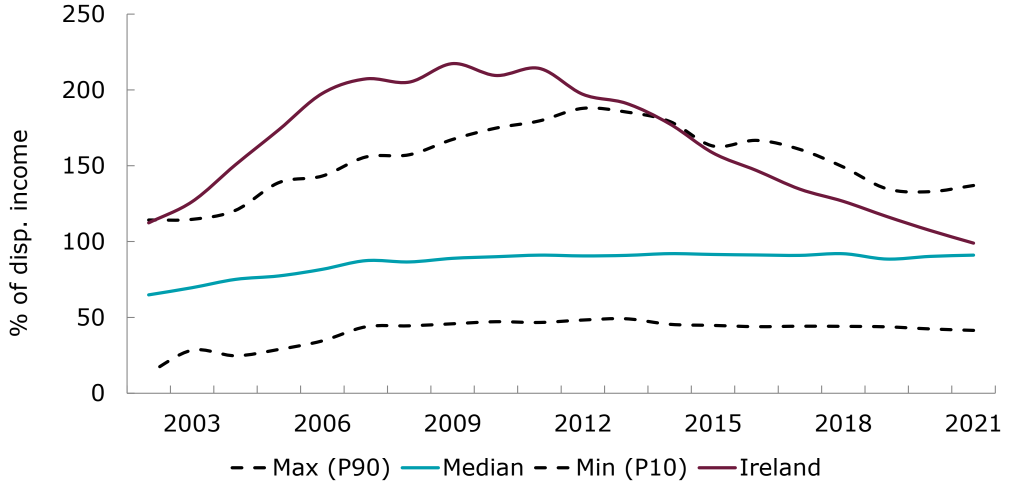


Source: Goodbody, Central Bank of Ireland

4. How will Ireland cope with rising interest rates?

After a decade-plus period of deleveraging, Ireland has gone from a very highly indebted economy in the aftermath of the GFC to one in the mid-rankings in the euro area. Lending flows have been consistently modest over recent years, while credit standards on this lending have been very conservative. This is particularly the case in relation to mortgage lending, where the mortgage rules have anchored the lending practices.

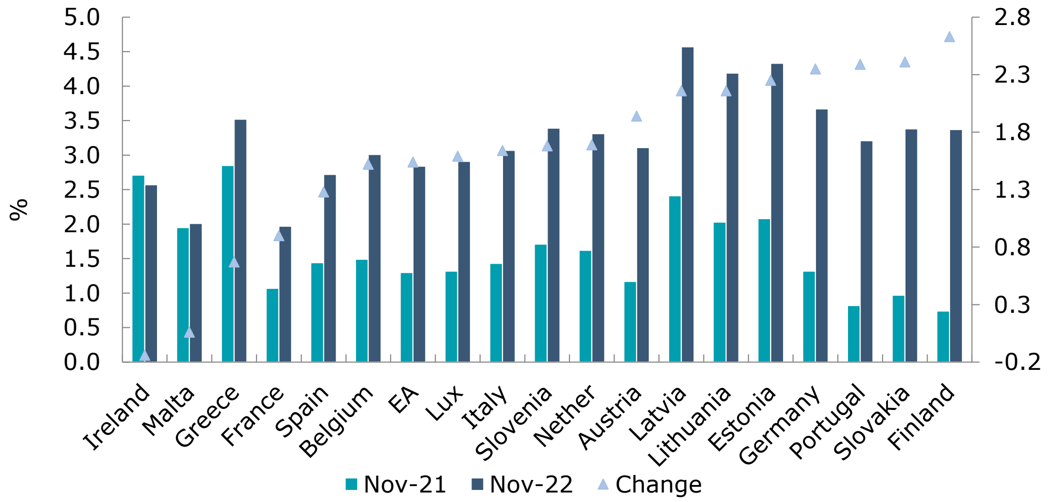
Household debt in Ireland is now at the euro area median



Source: ECB

Mortgages make up 83% of household loans in Ireland and are thus the most important potential risk as interest rates continue to rise in the euro area. To date, the pass-through to mortgage interest rates in Ireland has been very modest. The latest statistics for November show that there was no change in mortgage rates on new loans relative to 12 months previous. While there have been additional increases announced since then by some of the major lenders, the full pass-through is not occurring. We have assumed a 75% pass-through of ECB rate rises to fixed rate mortgage rates.

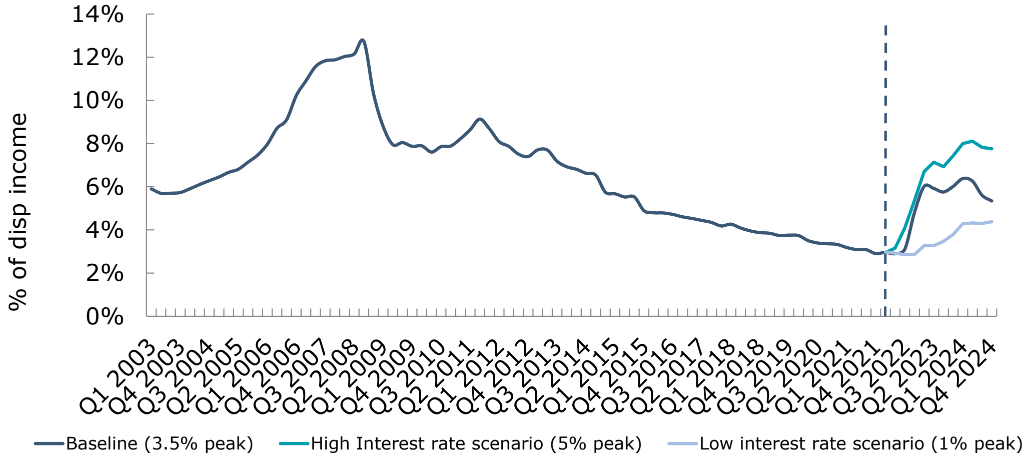
Mortgage interest rates in Ireland are lower than a year ago and among the lowest in the EA



Source: ECB

The following chart assesses the impact of potential interest rate increases on Irish households over the period to 2024. In our baseline scenario, the analysis suggests that the household interest bill (relative to disposable income) will increase to above 6% for the first time since 2014. However, this remains at half the peak level in 2008. The analysis provides comfort that the impact of rate rise can be managed by the majority of the household sector in Ireland.

Household interest bill to remain low despite rate rises



Source: Central Bank, Goodbody *assumed immediate 75% pass through of ECB rate rises so represents upper bound

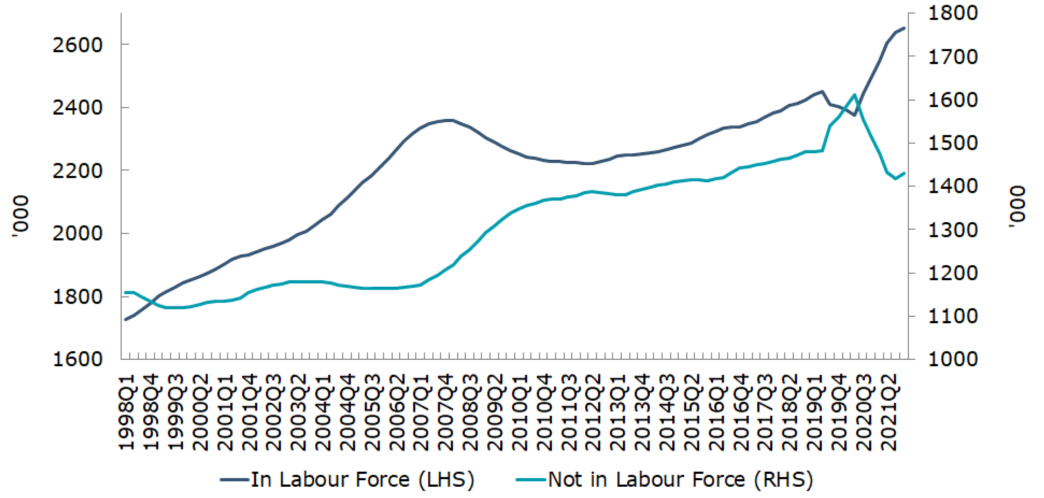
5. Softer growth to take steam out of a tight labour market

Rising employment and earnings continue to support households grappling with a rising cost of living. Some features of the labour market performance are common to other economies, but some are unique. Here we list some of the most important trends in the Irish labour market.

(i) Irish labour force bucking international trends

The labour force boomed to a record level of 2.7m in Q3 2022. This resulted in the number of people not in the labour force falling to its lowest level since 2015. This is the opposite to the trends in the UK and the US where labour forces have contracted. There have been two contributory factors to the growth in the Irish labour force. Firstly, participation rates for both males and females are risen to above pre-pandemic levels. Secondly, the growth in the working age population has been rapid (+2.4% in Q3 22).

Labour force has grown to a record high

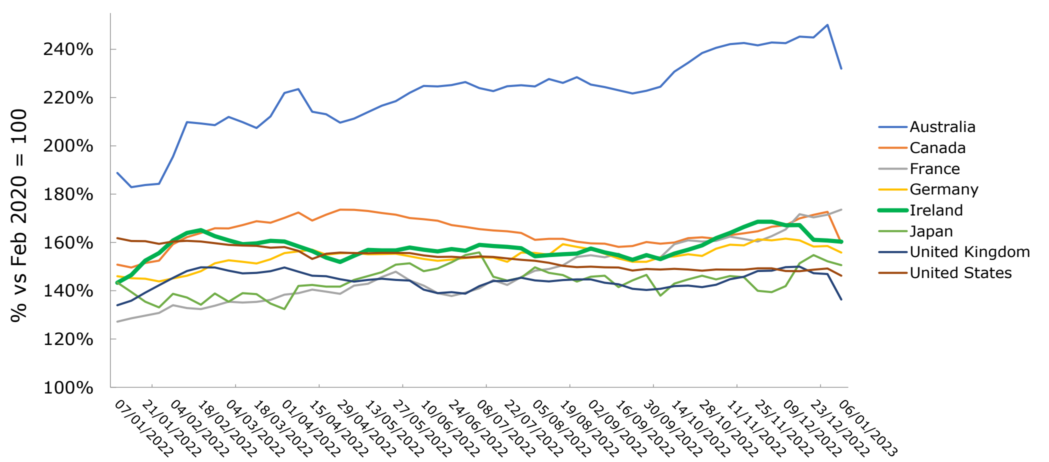


Source: CSO

(ii) Labour remains well above pre-pandemic norms

Labour demand remains high. High-frequency data by the *Indeed Hiring Lab* shows that job postings by firms globally rose from summer 2020 onwards. Ireland was among those economies that experienced a surge in labour demand, with job postings climbing to 67% above their pre-pandemic level by June 2022, before levelling off and holding around this level since then.

Job Postings vs February 2020 by Country

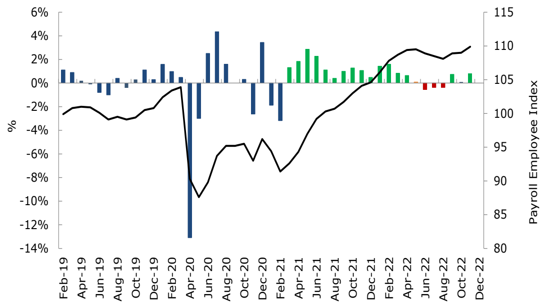


Source: Goodbody, Indeed Hiring Lab

(iii) Employment grew into year-end, while unemployment is close to all-time lows

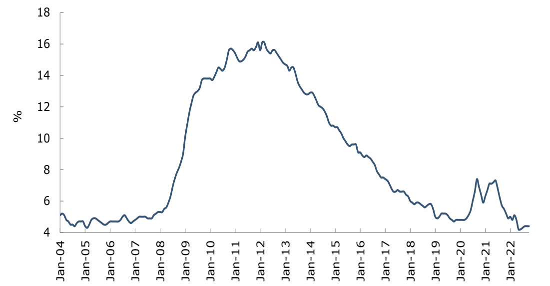
Having showing signs of easing in the middle of 2022, employment grew further to a new peak in the high-frequency CSO data, despite the concerns about tech layoffs in particular. This contributed to a renewed fall in the unemployment rate to 4.3% in December, leaving it close to all-time lows.

Employees on Payroll



Source: Goodbody, CSO

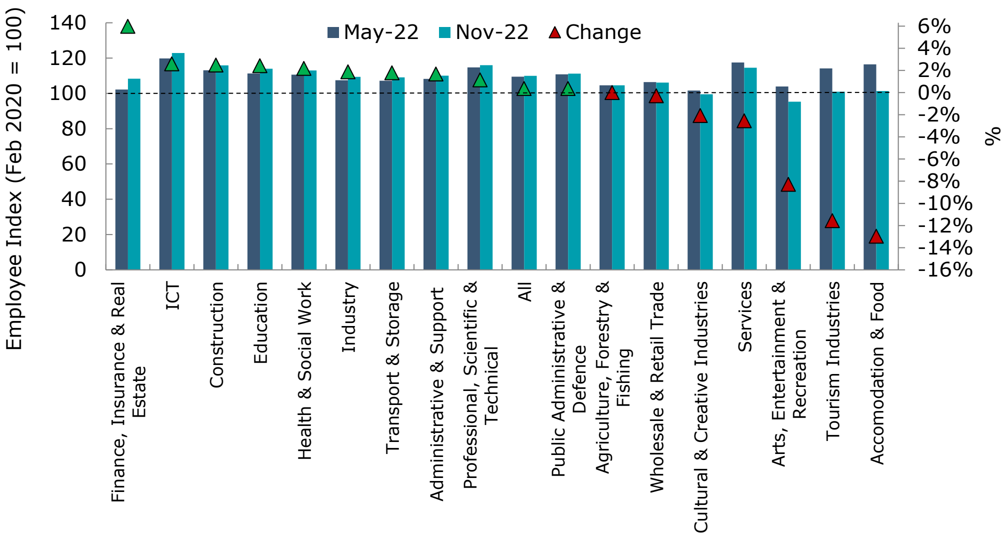
Unemployment Rate



Source: Goodbody, CSO

There are important differences across the labour market sectors. Accommodation and Food, Tourism, and Arts & Entertainment have seen a decline in employment since May 2022. Professional jobs in higher-paying sectors have continued to grow. Employment in Finance and Real Estate has risen by 6% since May 2022 while ICT employment (+3%) has also continued to grow.

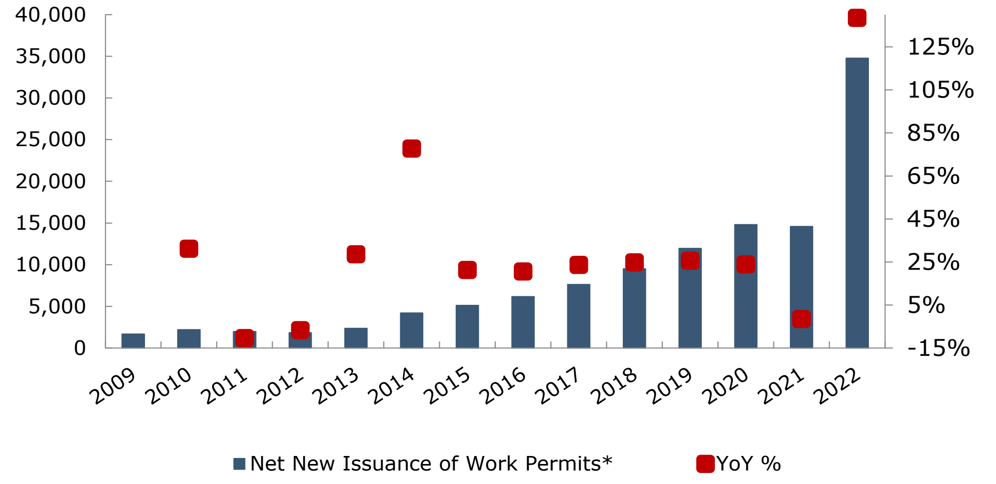
Trend in Employees on Payroll by Sector Since May 2022



Source: Goodbody, CSO

Migration has played a huge role in filling these jobs, with these migrants coming from increasingly diverse locations. EU and UK residents do not have to get a work permit to work in Ireland, but these now represent a minority of the immigrant flow. Data on work permits by the Department of Enterprise show that a record number of work permits were issued in 2022 (series dates back to 2009). There was a net new issuance of 35,000 work permits, up 125% on 2021.

Net New Issuance of Work Permits in Ireland 2009-2022*

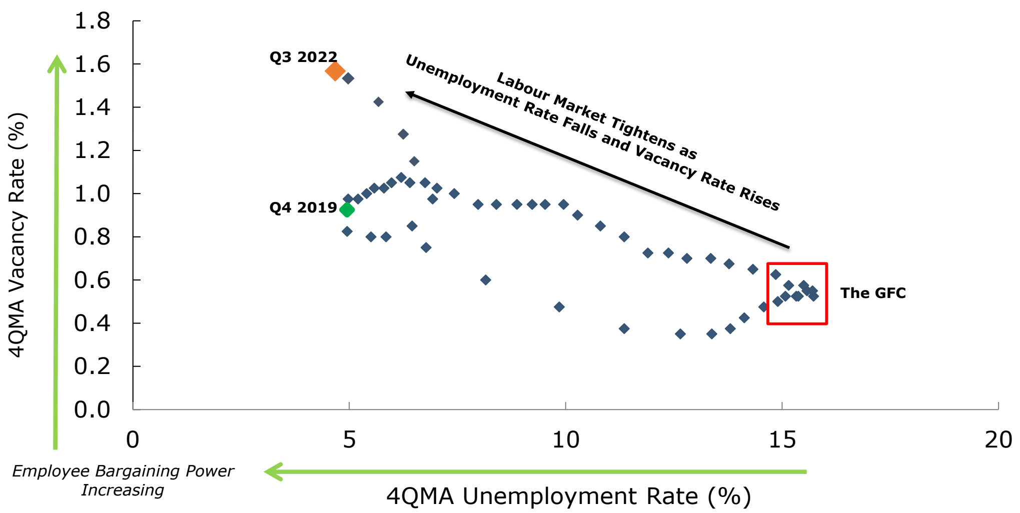


Source: Goodbody, Department of Enterprise

***The net new issuance of work permits is calculated by taking permits that are renewed, refused, and withdrawn from the total issuance number. From 2020 onwards, the Department of Enterprise do not report a renewals number. The figures for these years will be skewed upwards as a result. The underlying trend however still stands.**

A swift recovery in labour demand has resulted in the vacancy rate in Ireland rising to the highest on record. This is illustrated on Ireland's *Beveridge Curve*, which is a term used to describe the relationship between unemployment, vacancies, labour market tightness and thus, employee wage bargaining power. Typically, as the unemployment rate falls and the vacancy rate rises, bargaining power shifts in the workers' favour. As of Q2 2022, labour market conditions were the tightest they have been since the data series began in 2008. Risks to wage growth do indeed lie to the upside in the first half of 2023.

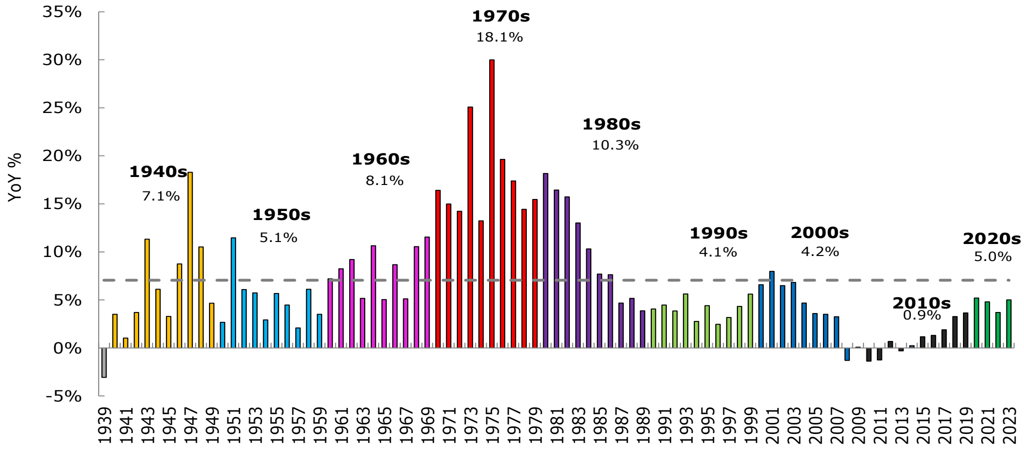
Ireland's Beveridge Curve



Source: Goodbody, CSO

Tight labour market conditions are reflected in rising wage pressures. Wage growth is expected to average 4.5% per annum over our forecast horizon. This is below the long-term average of 7%, but this period includes the high inflation period of the 1970s.

Wage Growth in Ireland 1939-2023*



Source: Goodbody, CSO

***Data are based on the same annual growth in average weekly earnings metric throughout the entire series. Data prior to 2008 are taken from a special analysis by the CSO published in 2017 on Irish earnings from 1939-2015, while data from 2008 onwards are taken from the Employment, Hours, Earnings, and Labour Costs Survey that is conducted quarterly by the CSO and did not begin until the foot of the Global Financial Crisis in 2008. In years where an economy-wide average weekly earnings figure was not available, we utilise the average weekly earnings in the industrial sector instead. This proxy is adopted for the years 1939-1942 and 1969-1974. Goodbody Economics forecasts are applied for the years 2022-2023.**

Labour Market Forecasts 2022-2024

	2018	2019	2020	2021	2022	2023	2024
Total at work ('000, end-year)	2,268	2,349	2,270	2,499	2,568	2,573	2,601
Employment Growth (end-year)	2.3%	3.6%	-3.4%	10.1%	2.7%	0.2%	1.1%
Employment Growth (Average)	2.8%	3.0%	-2.8%	6.0%	6.6%	0.9%	0.8%
Unemployment Rate (end-year)	5.7%	4.8%	6.3%	5.2%	4.5%	5.5%	5.8%
Wage Inflation	3.2%	3.7%	5.0%	4.8%	3.5%	4.5%	3.5%

Source: Goodbody, CSO

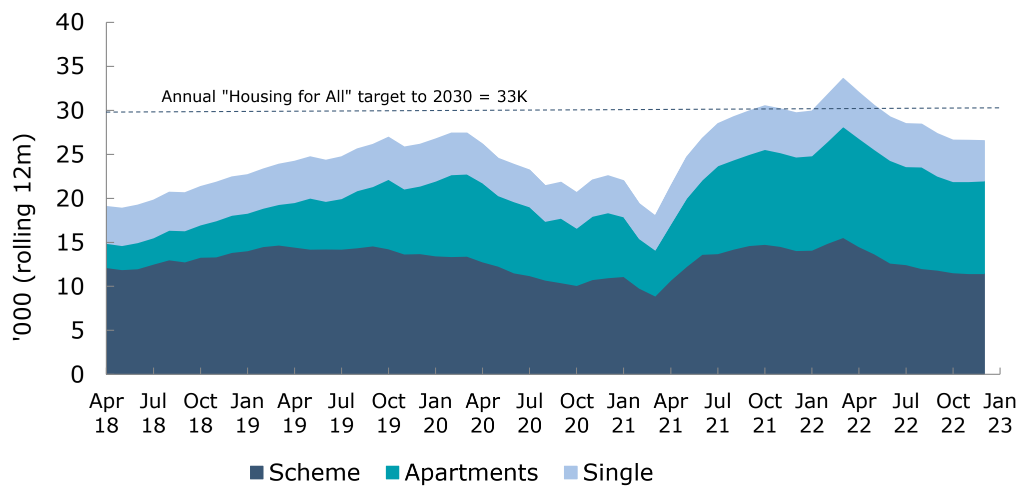
6. Government to become an increasingly bigger player in new housing supply

Having grown strongly since the ending of pandemic restrictions, there are signs that new housing supply in Ireland is now rolling over. This is happening at a time when housing demand is in fact growing at a faster pace, with a realisation that the government targets for housing supply will soon have to be revised upwards.

Housing supply targets under threat

Having risen to 34K in the twelve months to March 2022, housing commencements slowed to 27K for 2022 overall. While completions did grow strongly in 2022, this slowing in new activity is expected to feed through to lower new supply in 2023 and 2024. As a result, new supply will move further away from the government's targets under Housing for All.

Housing commencements trending downwards



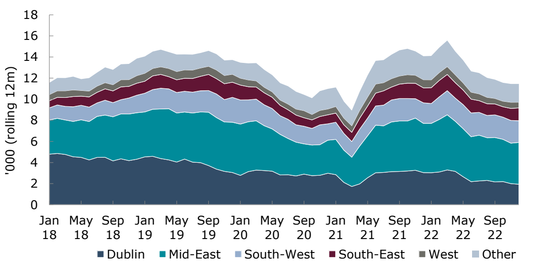
Source: Goodbody Analytics, BCMS

The slowing of new supply stems from two factors:

(i) **Apartment building threatened due to viability concerns** – The emergence of the institutional Private Rented Sector (PRS) over recent years has played a crucial role in funding the growth in the supply of apartments. The fall in residential yields was crucial in ensuring viability, but this trend reversed in 2022 as interest rates rose globally. Along with the rise in construction costs, the viability of apartment building is once again under threat, leading to a fall in new commencements and, in some cases, for existing projects to be stalled. As the chart below shows, this factor is very much a factor in Dublin, where apartment building has dominated in recent years.

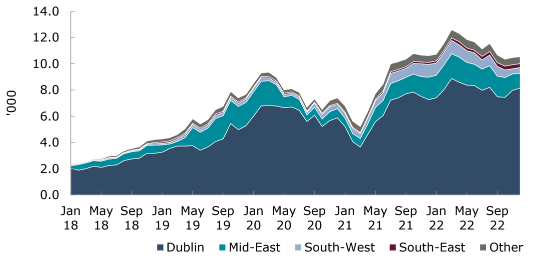
(ii) **House-building has fallen since 2018** – As shown below, in 2022 scheme housing starts were down by 17% relative to 2018. Most regions saw lower housing starts relative to 2018, with Dublin seeing the most dramatic fall of 55%. Outside of the two PLCs (Cairn and Glenveagh), the building industry has struggled to increase its output over recent years, with planning, funding and land availability acting as constraints. The government's policy aim to increase densities within housing developments has also curtailed the zoning of land for lower-density housing.

Commencements of housing schemes down by 17% since 2018...



Source: Goodbody Analytics, BCMS

...while apartments have dominated Dublin new supply; now under threat



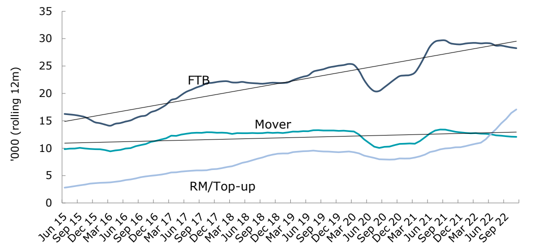
Source: Goodbody Analytics, BCMS

To prevent and further drop-off in supply, the Irish government will move to increase its funding and support for the sector. The Taoiseach has already indicated that the government would consider increasing this type of government support, thus replacing the funding and demand that would have came from the PRS sector. Despite this support, we believe that housing completions will fall to 27K in 2023 and 26K in 2024, from 29K in 2022.

New mortgage lending driven by remortgaging and higher loan sizes

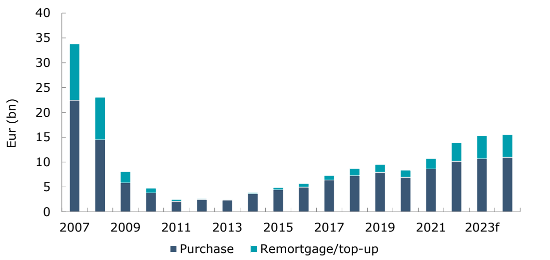
The stalling of new housing supply has implications for our mortgage market views. Both the volume (+8%) and value (+18%) of new lending for home purchases grew strongly in 2022. We anticipate that volumes of new mortgages for home purchase will flatline over the 2023/2024 period, with the growth in value coming about due to a further increase in average loan sizes for First-Time Buyers (FTBs) due to the increase in the Loan-to-Income limit to 4.0x. Most of the growth in gross lending in 2023 will come from the ongoing growth in remortgaging activity, although we believe this will fade as the year progresses and into 2024.

House purchase mortgage approvals have flatlined recently...



Source: BPFI, Goodbody

Increase in gross lending expected in 2023 due to remortgaging & high loan sizes



Source: BPFI, Goodbody

There are opposing drivers of mortgage demand and home prices in 2023. Demand continuing to exceed supply by a significant margin, employment is at record highs and wage inflation continues. In addition, the increase in the lending limits for FTBs and ongoing government supports for home ownership will support demand despite the rise in mortgage interest rates, which have been modest thus far. We do not, therefore, believe that prices will fall over the next two years, but do foresee a significant moderation in the rate of inflation.

Irish housing market forecasts

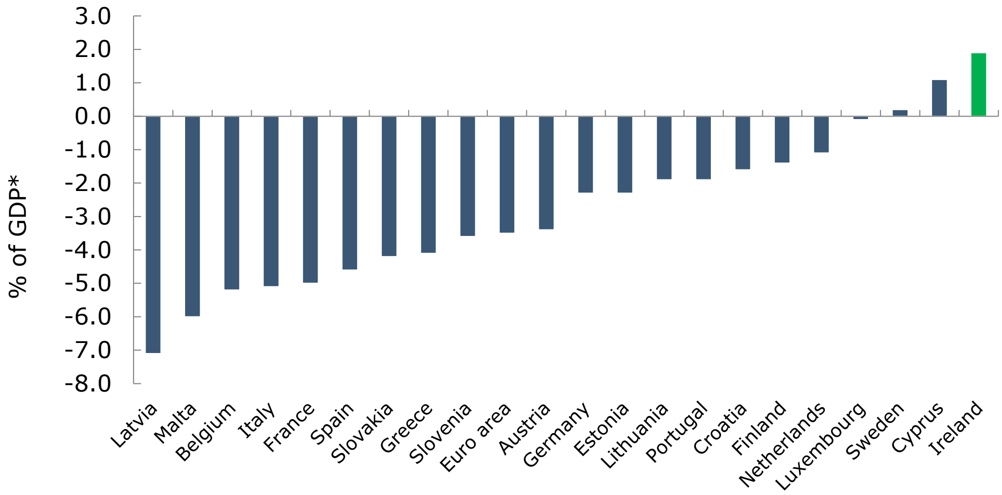
	2018	2019	2020	2021	2022e	2023f	2024f
New dwellings	17,889	21,113	20,585	20,560	28,373	27,322	26,047
Average price (€, end-year)	273,322	274,139	280,267	320,101	345,582	356,537	371,155
Price inflation (% YoY, end-year)	6.3%	0.3%	2.2%	14.2%	8.0%	3.2%	4.1%
- Dublin (% YoY, end-year)	3.9%	-1.7%	1.5%	12.8%	6.8%	4.0%	4.9%
- Non-Dublin (% YoY, end-year)	8.9%	2.5%	2.9%	15.2%	8.9%	2.7%	3.7%
Gross mortgage lending (€m)	8,723	9,542	8,367	10,701	13,888	15,308	15,512
Growth in gross lending	19.7%	9.4%	-12.3%	27.9%	29.8%	10.2%	1.3%
Net mortgage lending growth (end -year)	1.4%	1.9%	0.9%	1.2%	-0.6%	1.8%	2.2%
Rental growth	6.4%	4.5%	-3.2%	8.1%	7.2%	4.0%	4.0%
Gross rental yield (end-year)	5.4%	5.7%	5.4%	5.1%	5.0%	5.1%	5.0%

Source: Goodbody, CSO, DoHPLG, BPFI

7. Public finances the best in Europe provides room for fiscal supports

A boom in tax revenues in Ireland catapulted Ireland's public finances to the best position in Europe in 2022. Ireland finished the year with a budget surplus of 2% of GNI*, the biggest budget surplus since 2006.

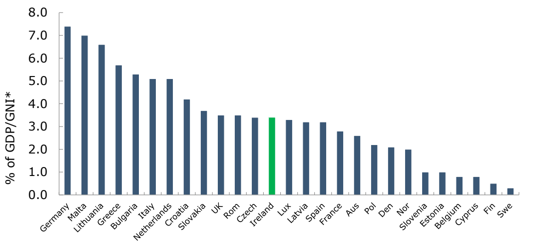
Ireland had the best fiscal position in the euro area in 2022



Source: AMECO, Goodbody, *GNI* for Ireland

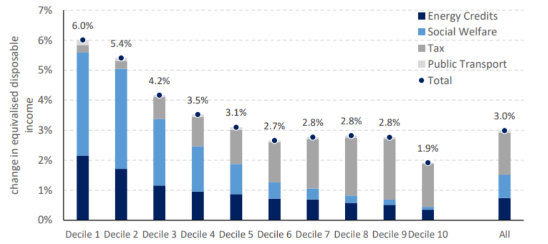
Coming after Brexit supports and COVID-related spending, the cost-of-living crisis has brought a need for further "temporary" fiscal measures for the Irish government. To date, the Irish government has provided €7.7bn in fiscal supports to help counter the effects of the rise in costs for businesses and households. This included €2.5bn in supports in Q4 2022 and a €2.2bn Budget 2023 package that will help in 2023. The biggest support will come via a €600 electricity credit, which will cost €1.2bn. Ireland currently sits in the mid-range in Europe in terms of the level of fiscal support (shown below). The support will, however, have a very significant role in mitigating the impact of rising household bills, particularly for those at the lower end of the income spectrum. The ESRI estimates that the measures announced to date will amount to 3% of disposable income on average, with the lowest income households benefiting by up to 6% of disposable income (see chart).

Cost of Living supports compared*



Source: Bruegel, DoF, CSO, Goodbody *since Sept 2021

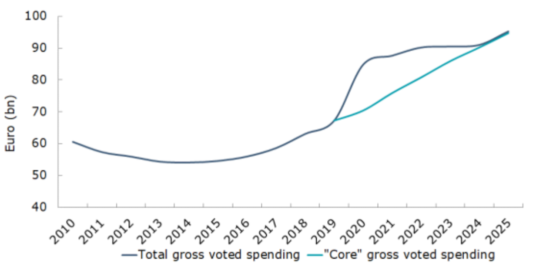
Impact of Irish measures by income decile



Source: ESRI

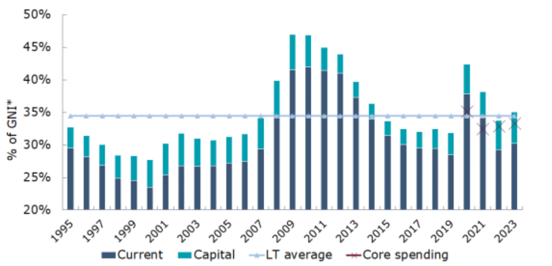
In Budget 2023, the government has set out total voted spending of €90.4bn, of which €4.5bn is described as non-core. This non-core spending includes €2bn for the cost of hosting Ukrainian refugees, €1.7bn in COVID spending and €0.8bn in other spending, including on the Brexit Adjustment Reserve. The Department of Public Expenditure and Reform has done a good job in recent years of separating the core and non-core elements of spending to ensure that the non-core element does not become engrained. Core spending has grown strongly over recent years, but remains below its long-term average level relative to GNI*. Given economic risks and the need for ongoing high levels of capital spending on housing, it is the correct policy decision to remain active on the spending front in the short-term, but there are longer-term risks to spending as a result of the aging of the population in particular.

Steady growth in "core" spending...



Source: Goodbody

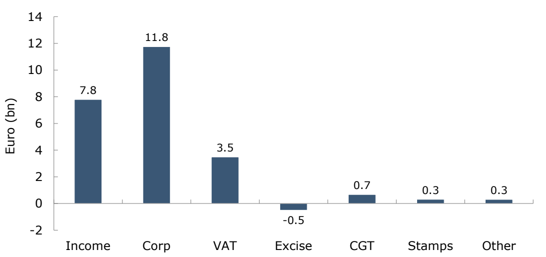
...but still below long-term average



Source: Goodbody

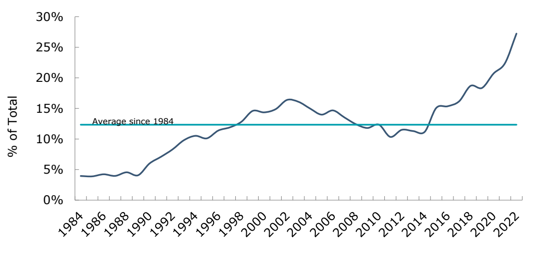
Although most tax headings contributed to the increase in tax revenues in 2022, corporation taxes were the biggest contributor by far, accounting for half of the annual increase. Since 2019, tax revenues have grown by an extraordinary 40%, with corporation tax more than doubling over the period. As a result, corporation tax represents 27% of total tax receipts, a record high. This reflects the boom in profitability of the multinational sector in Ireland over recent years.

Change in tax receipts – 2022 versus 2019



Source: DoF

Corporation taxes account for 27% of total

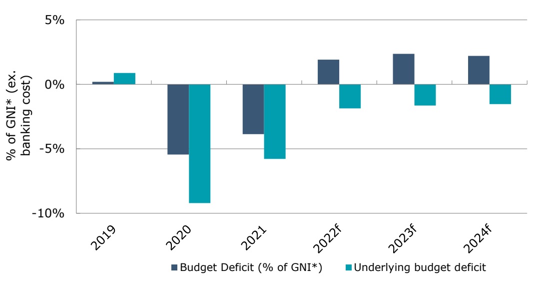


Source: DoF

The Irish government has long recognised the vulnerability of corporation tax revenues, given its size relative to the total and its concentration on a relatively small number of firms (ten firms represent 55% of the total). In Budget 2023, the Irish government moved to formally recognise this risk by reporting an "underlying" budget position which excludes an estimate of "windfall" corporation tax. For 2023, this is estimated at €10bn, resulting in an underlying deficit of 1.6% of GNI* (relative to a headline general government surplus of 2.4% of GNI*). With a general election due in just two years, the challenge will be to maintain this relatively healthy fiscal position in the context of demands for higher spending and tax cuts.

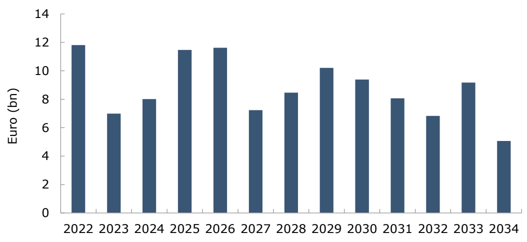
Debt metrics are now on a firm downward trajectory, with the debt/GNI* ratio expected to fall to 88% in 2023 and to 83% by the end of 2024. While this remains high in an historical context, it is below the euro area average of 92%. Along with the expected surpluses, Ireland also has relatively small redemption requirements over the 2023/2024 period, with only €7bn and €8bn redeeming over the next two years, respectively.

Headline budget surpluses to continue



Source: CSO, DoF, Goodbody

Modest bond redemptions in '23 & '24



Source: NTMA

Goodbody Fiscal Forecasts

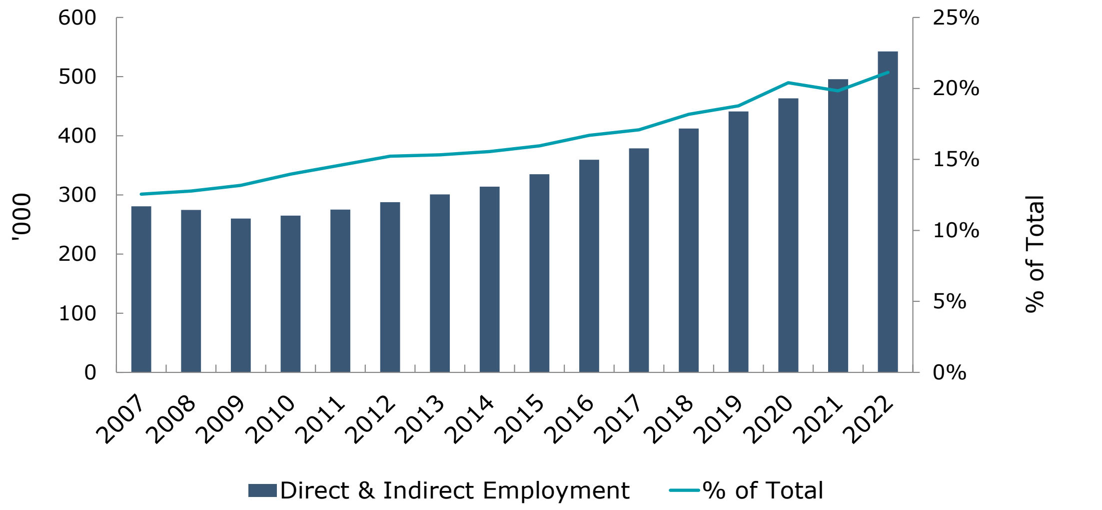
	2019	2020	2021	2022f	2023f	2024f
Budget deficit (Eur m)	533	- 15,379	- 8,522	4,430	5,758	5,364
Budget Deficit (% of GDP)	0.1%	-4.1%	-2.0%	0.9%	1.1%	1.0%
Budget Deficit (% of GNI*)	0.2%	-5.4%	-3.9%	1.9%	2.4%	2.2%
Underlying* budget deficit (% of GNI*)	0.9%	-9.2%	-5.8%	-1.9%	-1.6%	-1.5%
General Government Debt (Euro bn)	203	218	236	229	226	223
General Government Debt (% of GDP)	57%	58%	55%	46%	43%	41%
Debt/GNI*	97%	109%	101%	93%	88%	83%
Interest/GDP	1.2%	1.0%	1.0%	0.7%	0.7%	0.7%
Primary balance	1.4%	-3.1%	-1.0%	1.6%	1.8%	1.7%
Average interest rate	2.2%	1.8%	1.7%	1.6%	1.7%	1.6%
GDP growth (real)	5.4%	6.2%	13.6%	11.2%	2.3%	2.8%
GDP growth (nominal)	9.2%	4.5%	14.3%	17.7%	4.0%	4.4%

Source: DoF, NTMA, CSO, Goodbody

8. Tech sector unwind is a risk, but job losses are manageable thus far

Ireland's multinational sector played a crucial role in growth, employment and tax revenues over the pandemic period in particular. Last year was a record year for foreign direct investment, with Ireland now one of the leading countries globally in terms of attracting FDI. As a result, IDA-related companies were responsible for more than 500,000 jobs through direct and indirect employment. This is 22% of total employment. While this is a uniquely beneficial feature of the Irish economy, it also poses risks.

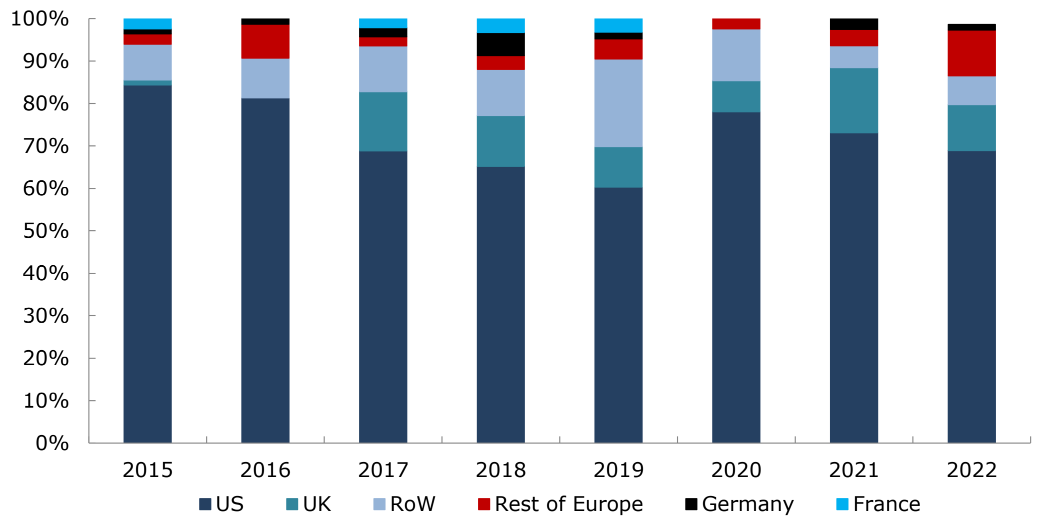
IDA-Related Employment in Ireland 2007-2022



Source: Goodbody, IDA

The flow of FDI into Ireland has been dominated by two regions that are highly exposed to recession - the US and the UK. With 80% of inward FDI originating from these regions, a cyclical downturn in these regions poses near-term risks for investment flows into Ireland.

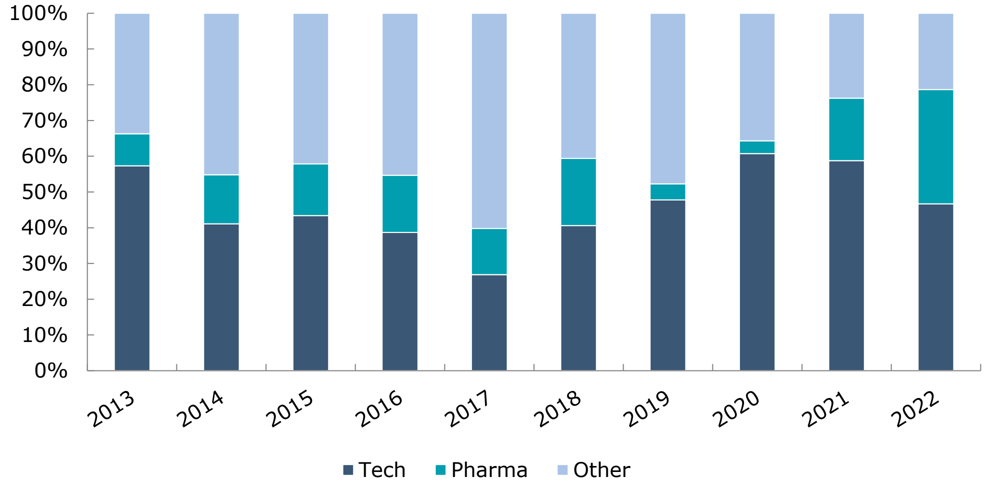
IDA Announcements by Region of Origin



Source: Goodbody, IDA

The concentration on a sectoral level contains its own risks, some of which are far more short-term in nature than the potential for recession. Of all companies that located to or expanded operations in Ireland throughout 2022, 80% were sourced in just two sectors, pharmaceuticals and technology.

IDA Announcements by Sector



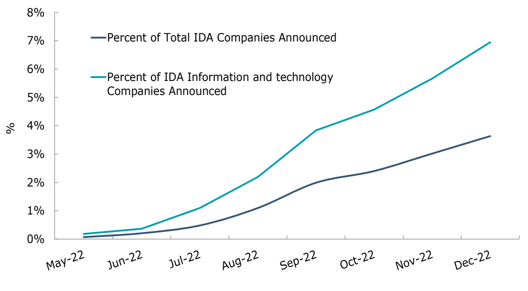
Source: Goodbody, IDA

Job losses in tech are manageable to date

Our Analytics team has estimated the current work force at risk of layoff in the Irish economy following announcements by IDA companies. In summary, the risk so far is relatively small. We estimate that 3% of IDA companies have announced layoffs from May - December 2022. This implies that c.8,500 in IDA companies has been laid off or is "at risk" of layoff as of December 2022. In addition, there was a record year in terms of job creation in IDA related companies last year, so it is very likely that there were still net gains in employment despite layoffs.

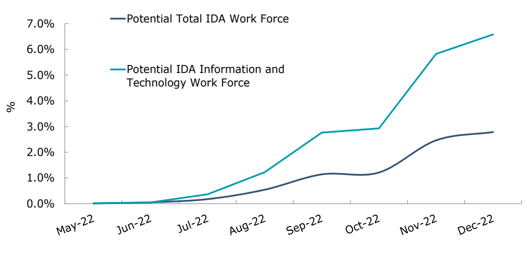
We maintain the view that technology and pharmaceuticals will be structural growth sectors for the Irish economy in the long-term. But there are clearly short-term risks due to the fall off in tech company valuations throughout 2022. They are, however, small in developments to date. Just 7% of tech companies associated with the IDA announced layoffs in 2022, resulting in a similar proportion of the IDA workforce in that sector being at risk of layoff. However, vacancies remain high in the sector and there has been an ongoing surge in work permits issued for the sector over the past twelve months.

IDA Companies Announcing Layoffs



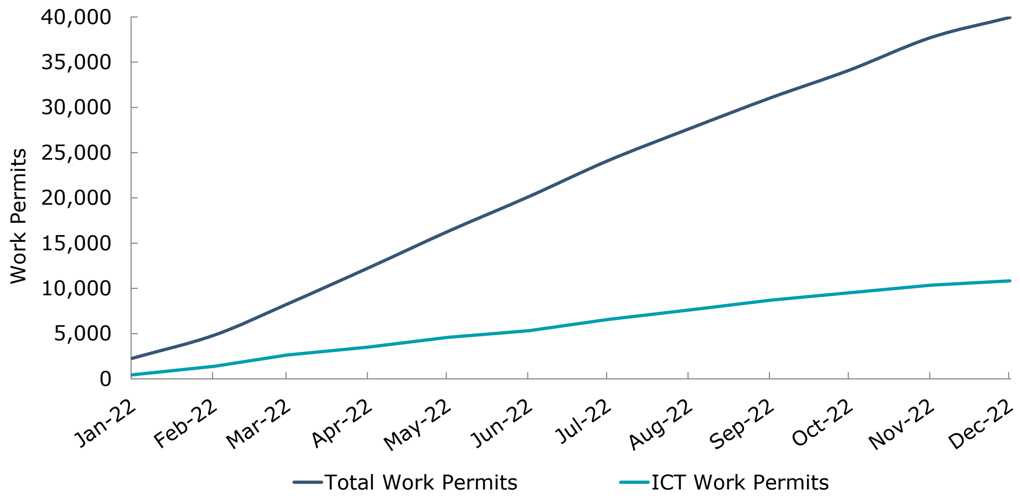
Source: Goodbody, IDA, LayoffTracker

IDA Labour Force "At Risk" of Layoff



Source: Goodbody, IDA, LayoffTracker

Work Permits Issued in 2022

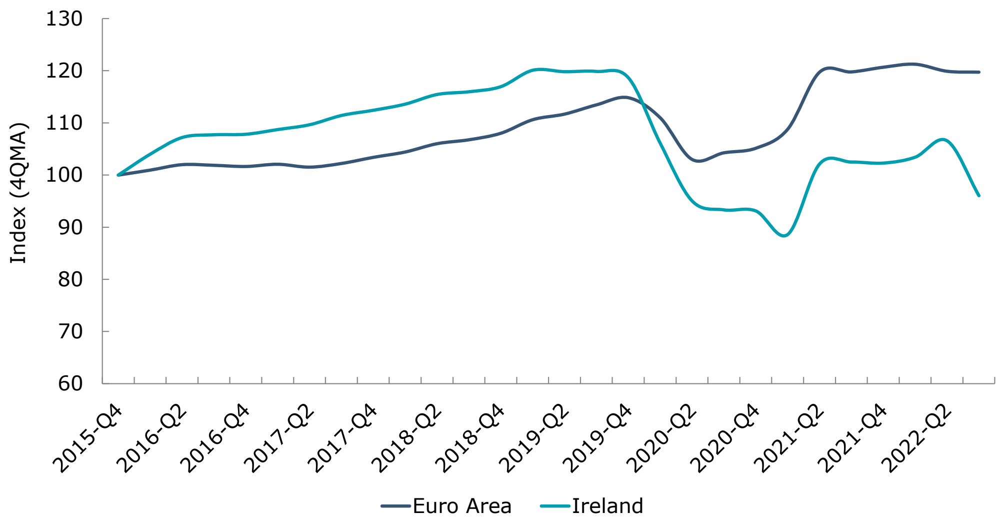


Source: Goodbody, Department of Enterprise

9. How will businesses fare in a tougher environment?

The higher cost and interest rate environment is providing challenges for the business sector. In Ireland, new business registrations have already shown signs of weakness, currently well below the Euro-Area average, and down 2% yoy in the twelve months to Q3 2022.

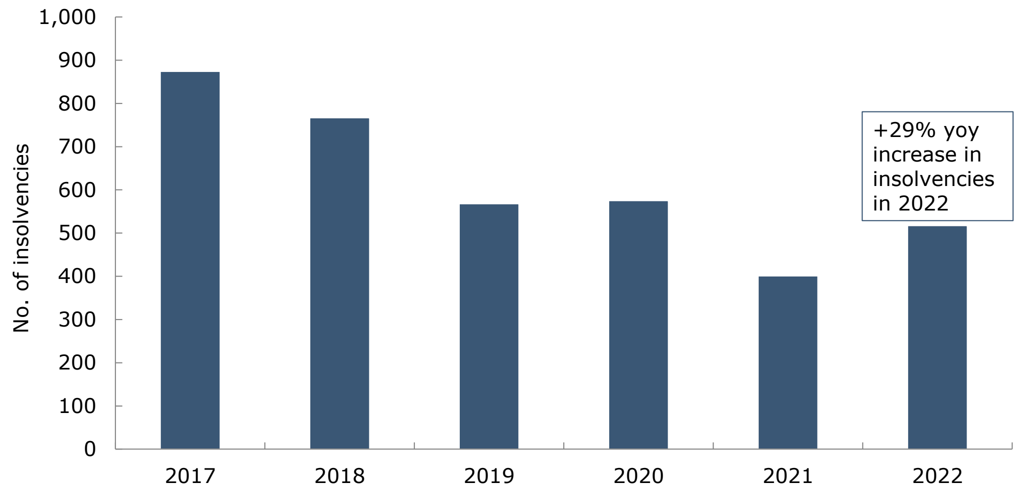
Business Registrations in Ireland vs Europe



Source: Goodbody, Eurostat

Ireland's business sector is relatively well-positioned entering 2023, with insolvencies remaining low in an historical context. Despite rising 29% yoy in 2022, insolvencies were still below 2019 levels. We expect insolvencies to rise this year, particularly in the hospitality sector, which will be faced with weaker demand and tough inflationary pressures. The biggest near-term risk for smaller businesses was the repayment of deferred tax liabilities, but the government has taken the sensible decision to delay the repayment of some of these liabilities.

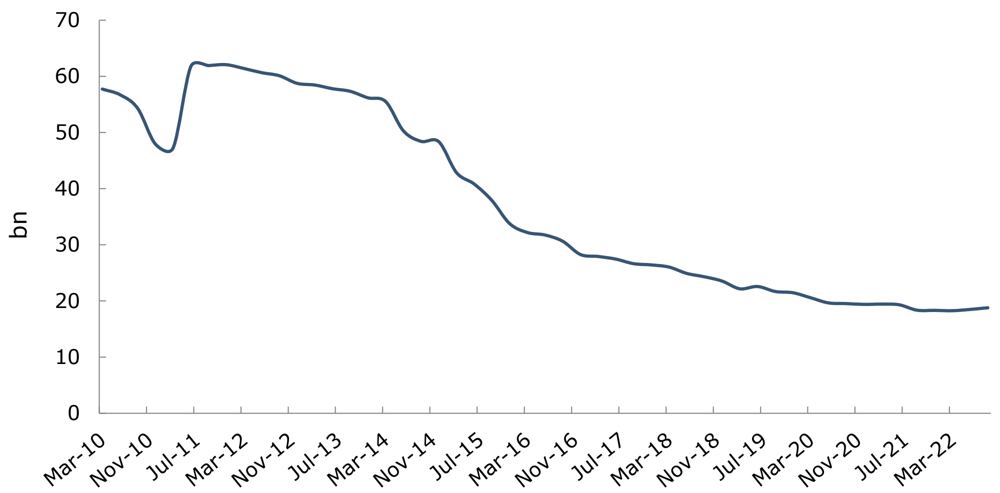
Corporate Insolvencies in Ireland 2017-2022



Source: Goodbody, Deloitte

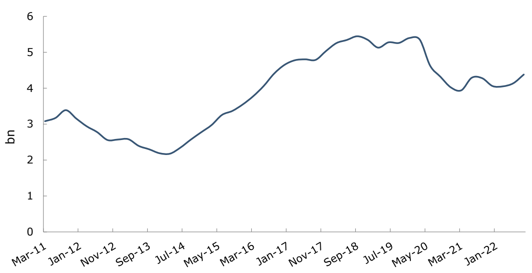
To offset some of the higher cost environment, firms may lean on credit. Currently, the stock of lending to SMEs remains well below GFC levels but has shown tentative signs of picking up. SME new lending was up by 2.4% in the year to September 2022 for the first time since the pandemic ended. The interest rate on new lending to SMEs is also rising. The rate was 3.7% in September 2022, up from 3.4% the previous quarter. This number will be higher again in Q4 2022 as further interest rate increases were pushed through by banks.

Stock of Outstanding Credit in the SME Sector



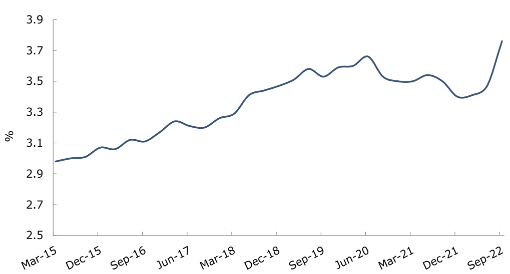
Source: Central Bank of Ireland

Flow of New Lending to SMEs (Rolling-12m)



Source: Central Bank of Ireland

Interest Rate on New Lending for SMEs



Source: Central Bank of Ireland

10. Supply-side investments must remain a priority

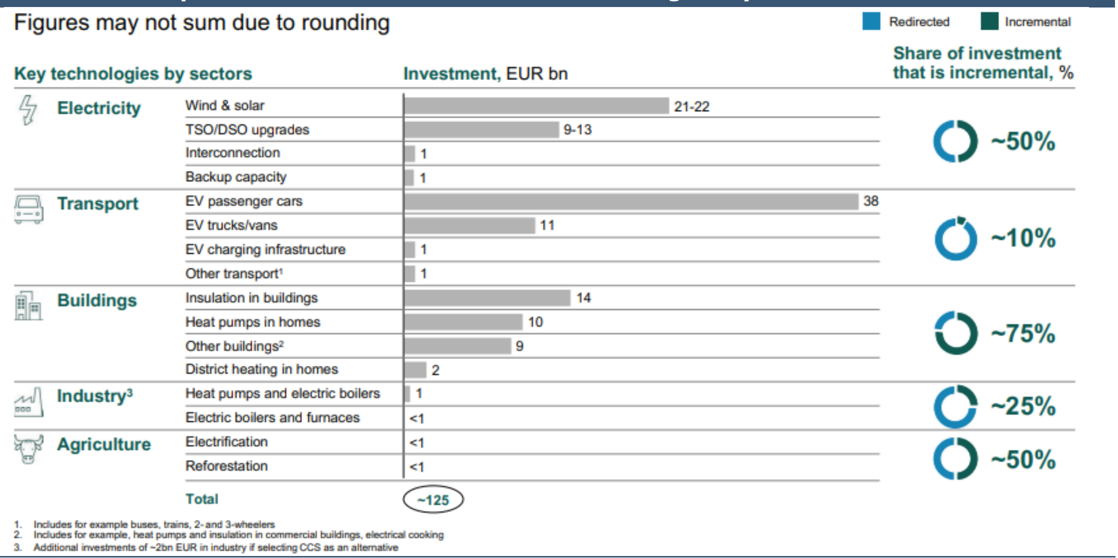
The growth in the population and employment over recent years has put a huge strain on the supply capacity of Irish economy. This has been evident in three areas in particular:

(i) **Housing supply** – As discussed earlier, supply continues to fall short of our medium-term estimates for housing demand. The arrival of record numbers of asylum seekers from Ukraine and elsewhere over the past twelve months has put even more pressure on this area, necessitating the use of emergency accommodation such as in hotels. This highlights that the accommodation crisis has far-reaching social, political, and economic consequences for Ireland.

(ii) **Labour supply** – The strong rebound post-lockdowns and the ongoing boom in demand from multinationals based in Ireland led to employment levels reaching record highs at the end of 2022. As discussed earlier, migration played a vitally important role in filling this demand in recent years. While the enlarged EU was a major source of labour supply in the mid-2000s, the biggest pool of labour for Irish employers is now the "Rest of the World". In 2022, the greatest number of work permits from ROW were to Indian and Brazilian migrants.

(iii) **Energy infrastructure and climate goals** – The European energy crisis brought about by the Russian war in Ukraine has lifted energy security and supply issues to the fore. This comes on top of the pressures that energy supply policy is under due to the ambitious goals set out under the Climate Action Plan. While Ireland has lower risks of a cessation of gas supplies and thus energy curtailments relative to continental Europe, risks to the country's energy supply has forced the government to ration the approval of data centres over the past twelve months. This sector has been growing rapidly in recent years, with the sector accounting for 14% of electricity usage in 2021, up from 5% in 2015. Given the increasing demand for data centres in high-tech industries and the heavy presence of the largest companies in the sector in Ireland, this sends out a negative message as to how Ireland is dealing with its energy security issues. In addition, the CAP highlights the scale of investment required for Ireland to meet its emissions reduction target of 51% by 2030. This will require a total investment of €125bn over the course of this decade.

Investments required to meet Greenhouse emissions targets by 2030



Source: Climate Action Plan 2021

The key point here is that while cyclical demand-side factors will fluctuate, the government need to focus on longer-term supply side goals if it is to maintain and build on the Irish economy's successes of the past few decades.

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